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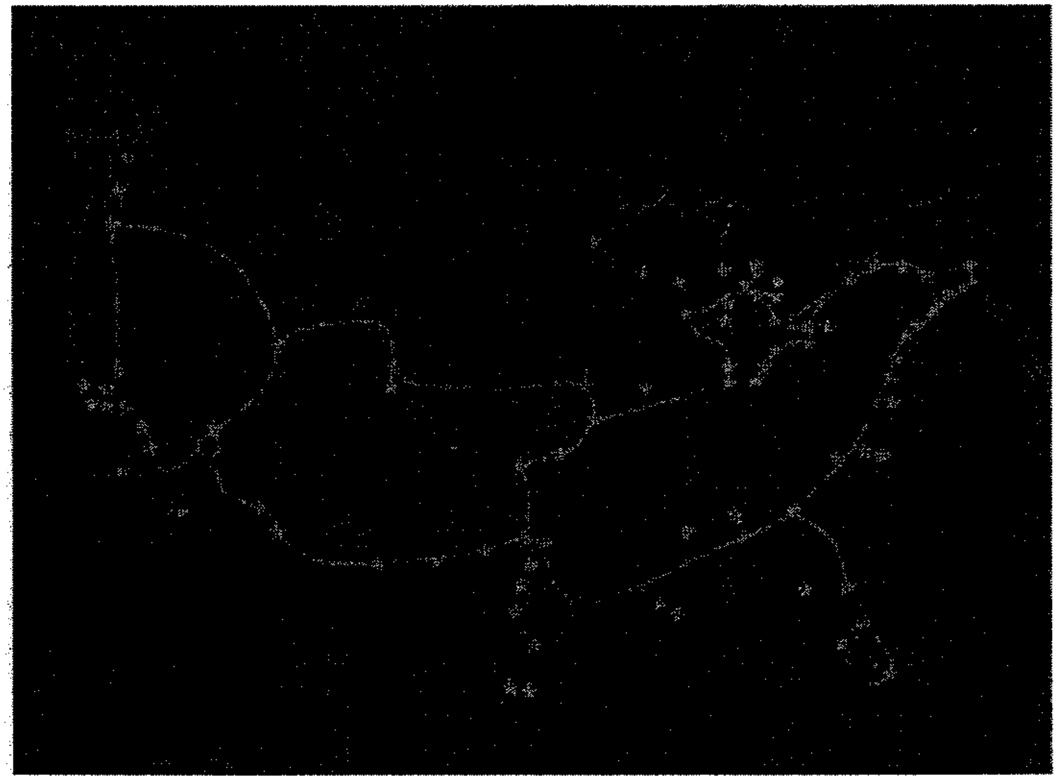
The following diagram depicts the physical components of our nationwide network.



Sales and Customer Care

Overview

Our sales organization includes a direct sales force and alternative channels. Our direct sales force is organized into four major markets in order to best match product, services and technological expertise with customer needs and expectations. The Large Enterprise team focuses on providing complex data and network applications to Fortune 2000, Global 500 and Private 250 companies. The Strategic Service Provider team focuses on carriers in the communications industry, including incumbent local exchange carriers ("ILEC's"), interexchange carriers ("IXC's"), other carriers and wireless providers. Our Government Solutions team focuses on providing data and networking applications to the U.S. Federal government. The Mid Market Enterprises team focuses on geographic markets in and around our network points of presence where Broadwing can bring compelling offers and value-added services to small to mid-sized businesses, communications service providers, as well as consumers. As of December 31, 2003, Broadwing had 396 employees associated with sales and customer care.

Direct Sales Force

We have established an experienced direct sales force. Our strategy is to structure our sales efforts to enable our sales personnel to establish direct and personal relationships with our customers. We seek to recruit salespeople with strong sales and communications backgrounds, including salespeople from communications service providers, communications equipment manufacturers, and network systems integrators. Salespeople are offered incentives through a commission structure that generally targets 40% to 50% of a salesperson's total compensation to be based on performance.

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Alternative Sales Channels

We have complemented our direct sales force by developing alternative sales channels to distribute the products and services available to our broadening customer base. These channels include numerous third party sales agents that generally receive commissions on monthly recurring revenue associated with sales contracts they bring to us.

Customer Care

Once a customer's services have been installed, our customer care operations support customer retention and satisfaction. Our goal is to provide customers with a customer care group that has the ability and resources to respond to and resolve customer questions and issues as they arise, 24 hours a day, seven days a week.

Regulatory Developments

Regulatory Requirements

The Telecommunications Act of 1996 (Telecommunications Act) became law on February 8, 1996. Among other things, the Telecommunications Act was designed to foster competition by establishing a regulatory framework to govern new competitive entry in the local and long distance telecommunications markets and to establish competition against the ILECs, such as Verizon and SBC. The Telecommunications Act entitles Broadwing to certain rights, but as a communications carrier, it also subjects Broadwing to regulation by the FCC and the states. Broadwing's designation as a communications carrier also results in other regulations that may affect Broadwing and the services it offers. The rights and obligations to which communications carriers are entitled and subject have been and likely will continue to be subject to litigation in the courts and further review and revision by the FCC and Congress.

The Telecommunications Act requires Broadwing to interconnect directly or indirectly with other communications carriers. In some cases, interconnecting carriers must compensate each other for the transport and termination of calls on their network. The FCC has limited the amount of compensation communications carriers may receive in certain situations. For example, local exchange carriers may assess interstate access charges on interexchange carriers whose customers access the local network. The FCC has issued an order implementing a benchmark for decreasing access rates that competitive local exchange carriers ("CLECs") can charge, moving such rates in alignment with lower ILEC access rates. The order is under reconsideration by the FCC. Changes in the access charge compensation scheme could affect Broadwing's revenues and costs. The FCC also is exploring methods to unify intercarrier compensation and is considering a bill-and-keep approach (*i.e.*, no compensation is paid between carriers) as well as other alternative modifications to the existing intercarrier compensation regimes. Broadwing's revenues may be affected by FCC and court decisions on these compensation matters.

The FCC also has adopted guidelines for implementing the interconnection and local competition provisions of the Telecommunications Act. In order to foster competition in the local exchange market, the FCC requires ILECs to offer access to certain portions of their communications networks (known as network elements) to competitors such as Broadwing at cost-based rates. The FCC's initial 1996 decision implementing the interconnection and local competition provisions of the Telecommunications Act has been appealed, reconsidered, and modified several times. In January 1999, the United States Supreme Court upheld the FCC's authority to require ILECs to offer portions of their network to communications carriers at cost-based rates. Similarly, in May 2002, the Supreme Court upheld the FCC's pricing methodology for developing cost-based rates.

In August 2003, the FCC modified the list of network elements to reduce the number of elements ILECs must offer to competitors. The FCC also initiated a comprehensive review of its pricing regime for network elements in 2003. In March 2004, the United States Court of Appeals for the District of Columbia vacated much of the FCC's August 2003 decision and remanded the case back to the FCC for further consideration. Although Broadwing does not rely solely on network elements purchased from ILECs, the outcome of any appeal or any subsequent FCC action could adversely affect Broadwing's ability to obtain the elements of the ILECs' networks it requires to provide service to its customers. In addition, any changes to the pricing scheme for network elements may affect Broadwing's revenues.

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In addition to these proceedings, there are several other competition-related issues that the FCC is reviewing as part of its ongoing examination of the competitive marketplace. First, the FCC is considering whether to adopt a set of performance measures and standards for certain ILEC services provided to other communications carriers to improve the quality of service competitors receive with respect to those services. ILEC quality of service issues may affect Broadwing's ability to provide services to its customers in a timely manner. Second, the FCC is considering how to regulate broadband services provisioned by ILECs and other wireline providers of broadband Internet access services. The outcome of this broadband proceeding may affect the degree of regulation to which Broadwing's Internet access services are subject in the future, including increased costs due to a finding that these services should be subject to universal service contribution requirements discussed below.

Broadwing is subject to federal and state regulations that implement universal service support for access to communications services by rural, high-cost, and low-income markets at reasonable rates; and access to advanced communications services by schools, libraries, and rural health care providers. Currently, the FCC assesses Broadwing for payments and other subsidies on the basis of a percentage of interstate revenue it receives from certain customers. The FCC adopted new rules regarding the assessment of universal service contributions in December 2002. Instead of assessing universal service contributions based on revenues accrued six months prior, contributions will now be based on projections of revenue. Also, the FCC placed limits on the mark-up carriers may place on the universal service line items on their customer bills. Several parties have asked the FCC to reconsider these rules. In addition, the FCC is considering assessing carriers' universal service contributions based on a flat-fee charge, such as a per-line or per-number charge. The FCC is also reviewing whether to impose universal service obligations on additional types of providers, such as broadband and Voice over Internet Protocol ("VoIP") service providers. States may also assess such payments and subsidies for state universal service programs. Any changes to the assessment and recovery rules for universal service may affect Broadwing's revenues.

Broadwing is also subject to other FCC requirements in connection with the interstate long distance services it provides, including the payment of regulatory fees to fund the Telecommunication Relay Services fund, local number portability administration, and the North American Numbering Plan. Many states also impose regulatory fees on Broadwing.

Broadwing is also subject to regulation by the state commissions in each state in which it provides service. Broadwing's regulatory obligations vary from state to state and include some or all of the following requirements: filing tariffs (rates, terms and conditions); filing operational, financial, and customer service reports; seeking approval to transfer the assets or capital stock of the telephone company; seeking approval to issue stock, bonds, and other forms of indebtedness of the telephone company; reporting customer service and quality of service requirements; making contributions to state universal service support programs; geographic build-out; and other matters relating to competition.

Many communications carriers, including Broadwing, are starting to offer Internet Protocol ("IP") services. To date, IP-based services have been treated as "information services," which are traditionally subject to a lesser degree of regulation than communications services. The FCC, state commissions, and Congress have initiated proceedings to investigate the legal and regulatory implications of IP-based services. The outcome of these proceedings could affect the regulatory classification of IP-based services provided by Broadwing and the regulatory obligations imposed on Broadwing in its provision of these services.

Regulation of Rates

Broadwing is subject to the jurisdiction of the FCC with respect to interstate and international rates, lines and services, and other matters under the statutory requirements of Title II of the Telecommunications Act of 1934. Broadwing must offer communications services under rates, terms and conditions that are just, reasonable and not unreasonably discriminatory. It also is subject to the FCC's complaint process, and it must give notice to the FCC and affected customers prior to discontinuance, reduction or impairment of service.

In addition, state public utility commissions or similar authorities having regulatory power over intrastate rates, lines and services and other matters regulate Broadwing's intrastate communications services. The system of regulation applied to Broadwing's intrastate communications services varies from state to state and generally includes various forms of pricing flexibility rules.

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Competition

Competition in communications services is based on price and pricing plans, types of services offered, customer service, access to customer premises and communications quality, reliability and availability. Broadwing's principal competitors include AT&T, MCI, Sprint Corporation, Level 3 Communications, Inc., Qwest Communications International, Inc.,, Wiltel Communications, LLC, and regional phone companies. In addition, communications providers have been facing competition from non-traditional sources such as Internet-based services, high-speed cable Internet service, e-mail ,and wireless services.

Broadwing currently faces significant competition and expects that the level of competition will continue to increase. In addition, the Telecommunications Act permits regional phone companies to provide in-region interLATA interexchange services after demonstrating to the FCC that providing these services is in the public interest and satisfying the conditions for developing local competition established by the Telecommunications Act. All Bell Operating Companies ("BOCs") have obtained authority to offer long distance services. As competitive, regulatory, and technological changes occur, including those occasioned by the Telecommunications Act, we anticipate that new and different competitors will enter and expand their position in the communications services markets. These will include regional phone company competitors plus entrants from other segments of the communications and information services industry. Many of these new competitors are likely to enter with a strong market presence, well-recognized names, and pre-existing direct customer relationships. A continuing trend toward business combinations and alliances in the communications industry also may create stronger competition for Broadwing. In addition, a substantial number of customers seek to purchase local, interexchange and other services from a single carrier as part of a combined or full service package. Thus, the simultaneous entrance of numerous new competitors for combined service packages is likely to materially adversely affect Broadwing's future revenue and earnings.

Equipment

Overview

Our equipment services division designs, manufactures and sells high performance all-optical and electrical/optical communications systems that we believe can accelerate carrier revenue opportunities and lower the overall costs of network ownership for carriers. We also provide installation and professional services that support our product offerings. We believe our optical products enable a fundamental shift in network design and efficiency by allowing for the transmission, switching and management of communications traffic entirely in the optical domain. These products include terrestrial ultra-long distance optical signal transmission, reception and amplification equipment, all-optical and electrical/optical switching equipment and software that enable the creation of all-optical and optical backbone networks. By deploying our products, carriers eliminate the need for expensive and bandwidth-limiting electrical regeneration and switching equipment, significantly reducing costs, increasing network capacity and allowing them to more quickly and efficiently provide new services. Our products allow carriers to provision and use their existing networks more efficiently, enabling the transmission of optical signals in greater capacity over longer distances than existing technology.

Starting in 2001 and continuing through 2003, conditions within the general economy and communications sector have resulted in significantly reduced capital expenditures by carriers and a reduced demand for our equipment division product and services. These declines have had a severe impact on our equipment revenue and results of operations.

In response to these conditions, we have implemented a series of restructuring initiatives within our equipment division designed to decrease our business expenses and to conserve our resources. The actions included staff reductions, facility consolidations and the curtailment of discretionary spending. These restructuring plans have been reflected in our results of operations in 2001, 2002 and 2003. Our equipment business employees are now focused strategically on selective engagement with customers, including the U.S. Government, servicing existing customer networks, and maintaining certain business operations and supporting the Broadwing network. The communications services division is now the major focus of the Company and revenues from the communications services division will account for most of Corvis' revenues for the foreseeable future.

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Equipment Technology and Products

We leverage our industry leading technology to implement innovative optical transport and switching solutions to fulfill carrier networking requirements. Our product lines include electrical/optical and all-optical switching products, ultra long-haul and point-to-point optical transport systems and network management software that enables seamless end-to-end network management. This range of product lines enables us to provide carriers solutions for their traditional ring networks, as well as their electrical/optical and all-optical mesh networks. Another advantage of our solution is our in-service migration strategy that enables carriers to migrate their current network infrastructure from point-to-point links to a more efficient all-optical mesh infrastructure. The flexibility afforded by the ability to migrate their network infrastructure enables carriers to maximize profitability by matching transport network infrastructure with service requirements and deployment strategies.

Corvis OCS

The Corvis Optical Convergence Switch (OCS) is one of the industry's highest density, optical-electrical-optical (OEO) cross-connect switch providing standard point-to-point, ring and mesh networking functionality enabling carriers to deliver current SONET/SDH services. We believe the Corvis OCS provides the following advantages:

- Lowers expenditures to install and operate a communications network by providing enhanced density, scalability and flexibility when compared to current legacy network devices;
- Provides industry standard "open" interfaces to support multi-vendor compatibility with existing network equipment that complies with industry standards;
- Provides for efficient management, grooming, and aggregation of up to 240 gigabits of STS-1 traffic in a single shelf;
- Allows for in-service expansion on an incremental basis to provide "pay-as-you-grow" support for up to 720 gigabits of STS-1 traffic in a single rack;
- Designed to support fully non-blocking switching capacity up to 11.5 terabits of STS-1 traffic in a single network element in the future;
- Provides grooming and switching down to the STS-1/VC-4 level;
- Facilitates rapid service provisioning of sub-wavelength and wavelength services across the optical transport infrastructure; and
- Provides for protection and restoration of services across the optical transport infrastructure.

Corvis ON

The Corvis Optical Network (ON) is an innovative portfolio of integrated optical transport and all-optical switching products that utilizes industry leading technology to enable all-optical and electrical/optical networking solutions with ultra-long haul transport to support SONET/SDH, IP and other next-generation services over backbone networks. Our integration of these technologies allows carriers to build higher capacity, more flexible and more cost-effective networks. Our integrated ultra-long haul and long haul optical transport and all-optical switching products have been deployed in carrier networks, including Broadwing's network, carrying commercial traffic for over three years.

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Network Management

Our suite of software tools provides carriers with fault detection and administration and configuration at the service, element, and network levels in addition to network planning capabilities. Our software tools are designed to accelerate network planning and provisioning and the implementation of services across the optical network as well as to facilitate network monitoring, maintenance, and troubleshooting. This results in an end-to-end point-and-click management solution that helps carriers increase the speed of service delivery and revenue generating opportunities while reducing costs.

Competition

We compete in a rapidly evolving and highly competitive equipment market. The market for our products has historically been dominated by companies such as Alcatel, Cisco, Lucent, Nortel and Ciena. We expect to continue to compete with these and other established and new market entrants. We believe that the principal competitive factors in our market include:

- price;
- product performance, including high-capacity transmission over long distances without regeneration;
- speed and cost of deployment;
- speed and cost of service provisioning;
- ability to reconfigure or increase network capacity;
- integrated network management under software control;
- compatibility with existing equipment;
- ongoing customer service and support;
- perceived financial strength and longevity; and
- willingness to offer product financing.

Many of our competitors have longer operating histories, greater name recognition, larger customer bases and greater financial, technical and sales and marketing resources than we do and may be able to undertake more extensive marketing efforts, adopt more aggressive pricing policies and provide more vendor financing than we can. To remain competitive, we must continue to develop our products and adjust our customer support organization to address customers' evolving expectations and current market conditions.

Intellectual Property

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We require our employees and consultants to execute non-disclosure and proprietary rights agreements at the beginning of employment or consulting arrangements with us. These agreements acknowledge our exclusive ownership of all intellectual property developed by the individual during the course of his or her work with us and require that all proprietary information disclosed to the individual remain confidential. We intend to enforce vigorously our intellectual property rights if infringement or misappropriation occurs. However, we do not expect that our proprietary rights in our technology will prevent competitors from developing competitive technologies.

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Given the technological complexity of our products, we can give no assurance that claims of infringement will not be asserted against us or against our customers in connection with their use of our systems and products, nor can there be any assurance as to the outcome of any such claims. On July 19, 2000, Ciena filed a lawsuit alleging that we are willfully infringing three of Ciena's patents relating to optical networking systems and related dense wavelength division multiplexing ("WDM") communications systems technologies. A fourth patent was subsequently added to the lawsuit. In general, the technologies at issue involve how some of our equipment is used to transmit and receive communication signals between two points in the network. In February 2003, interim jury trials were held on the issues of infringement and invalidity of the four patents. Corvis all-optical networking products were found not to infringe two of Ciena's WDM system patents. The jury did not reach a verdict on a third Ciena WDM system patent, which is related to the two non-infringed WDM system patents. Corvis' OC-192 inverse multiplexing transceiver product, which can generally be described as a device that separates higher speed signals into lower speed signals for transmission and then recombines the lower speed signals after transmission that can be used along with our all-optical networking products, was found to infringe a Ciena patent on bit rate transparent devices. In an April 2003 retrial, the manner in which certain Corvis OC-48 transmitters and receivers convert the signals from optical form to an electronic form and back again, in a WDM system was found by a jury to infringe the patent, upon which a jury verdict was not reached in the February 2003 trial. The jury verdicts to date are interim verdicts, in so far as additional trial court proceedings remain before a decision is made by the court and judgment is entered. In May 2003, we filed a motion to certify the record for interlocutory appeal to the U.S. Federal Circuit Court of Appeals and Ciena filed motions for entry of judgment and for a permanent injunction, all of which are pending. In February 2004, our motion requesting a jury trial on a pending infringement issue was denied and we filed a Writ of Mandamus with the U. S. Federal Circuit Court of Appeals requesting that a retrial be ordered. See "Item 3. Legal Proceedings."

We own more than 180 issued U.S. and foreign patents, and more than 200 pending U.S. and foreign patent applications. We also license certain patents covering components, which require us to pay modest royalties when used. These licenses are directed generally to the following technologies: the manufacture of Bragg Gratings; compression-tuned fiber gratings; temperature compensated optical waveguide devices; and wavelength selective optical switches. Most of these patent licenses expire on the earlier of the date the last licensed patent expires or is abandoned by the licensor. The licenses are expected to expire on February 16, 2014; September 30, 2014; December 26, 2009; and September 23, 2014, respectively. These expiration dates assume that the licensed patents are not abandoned at an earlier date by the licensor. Furthermore, the licenses may also terminate earlier if certain events occur, such as if we breach the contract.

At least some of these licenses provide for the inclusion of additional patents which were not included at the time of entering into the license. The additional patents, if any, may be U.S. or foreign patents. We may not be notified by the licensor when the additional patents, if any, are added to the license. As a result, it is possible for the scope and expiration dates of the licenses to be different than those specified above.

We also license certain software components for our network management software. These software licenses are perpetual but will generally terminate if we breach the agreement and do not cure the breach in a timely manner.

Companies in our industry whose employees accept positions with competitors frequently claim that their competitors have engaged in unfair hiring practices or trade secret misappropriation. We have received claims of this kind in the past and we cannot assure you that we will not receive claims of this kind in the future as we seek to hire qualified personnel or that those claims will not result in material litigation. In March 1999, we filed suit against Ciena asking the court to invalidate noncompete agreements between Ciena and six former Ciena technicians and assemblers formerly employed by us. Ciena filed a counterclaim against us, the former employees and Dr. David Huber, our Chief Executive Officer and a former employee of Ciena, seeking injunctive relief and unspecified monetary damages for various alleged activities, including conspiracy, breach of contract, unfair competition and theft of intellectual property. Although we believed Ciena's counterclaims to be unfounded, we ultimately settled the litigation without prejudice to either party. If Ciena were to refile this suit, or any other party were to file a similar suit, an adverse judgment could result in monetary damages or an injunction that could materially affect our business. In addition, as with any suit, regardless of the suit's merits we could incur substantial costs defending ourselves and/or our employees. Also, defending ourselves from such claims could divert the attention of our management away from our operations.

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Employees

As of December 31, 2003, we employed 1,213 persons, of whom 1,021 were engaged in our communications services division, 192 in our equipment services division including 36 in general corporate activities.

Item 2. Properties.

Our properties consist primarily of plant and equipment used to provide communications services as well as administrative offices, sales offices, manufacturing and research facilities associated with our equipment division.

Plant and equipment associated with communication services consists of central office equipment, including switching and transmission equipment; our long haul fiber optic backbone; land and buildings. The majority of our fiber optic backbone has been developed through long-term indefeasible rights of use (IRU) agreements, in which we obtained the right to use specified fibers owned by third parties; or through construction of owned fiber optic facilities placed on third party properties under right-of-way agreements. The original term of these leases generally are 20 years.

We also operate a number of sales offices, customer care centers, and other facilities, such as research and development laboratories. The majority of these properties are leased.

Corvis Corporation continues to manage the deployment and utilization of its assets in order to meet its growth objectives while at the same time ensuring that these assets are generating value for our shareholders.

Item 3. Legal Proceedings

Ciena

By letter dated July 10, 2000, Ciena Corporation ("Ciena") informed us of its belief that there is significant correspondence between products that we offer and several U.S. patents held by Ciena relating to optical networking systems and related dense wavelength division multiplexing ("WDM") communications systems technologies. In general, the technologies at issue involve how some of our equipment is used to transmit and receive communication signals between two points in the network. On July 19, 2000, Ciena filed a lawsuit in the United States District Court for the District of Delaware alleging that we are willfully infringing three of Ciena's patents. Ciena is seeking injunctive relief, monetary damages including treble damages, as well as costs of the lawsuit, including attorneys' fees. On September 8, 2000, we filed an answer to the complaint, as well as counter-claims alleging, among other things, invalidity and/or unenforceability of the three patents in question. On March 5, 2001, a motion was granted allowing Ciena to amend its complaint to include allegations that we are willfully infringing two additional patents. One patent was dropped from the litigation by agreement of the parties prior to trial. In February 2003, jury trials were held on the issues of infringement and invalidity of the remaining four patents. Our all-optical networking products were found by a jury not to infringe two of Ciena's WDM patents. The jury did not reach a verdict on a third Ciena WDM patent, which is related to the two non-infringed WDM patents. Corvis' OC-192 inverse multiplexing transceiver product, which can generally be described as a device that separates higher speed signals into lower speed signals for transmission and then recombines the lower speed signals after transmission that can be used along with our all-optical networking products, was found by the jury to infringe a Ciena patent on bit rate transparent devices. In an April 2003 retrial, the manner in which certain Corvis OC-48 transmitters and receivers convert the signals from optical form to an electronic form and back again, in a WDM system was found by a jury to infringe the patent, upon which a jury verdict was not reached in the February 2003 trial. The jury verdicts to date are interim verdicts, in so far as additional trial court proceedings remain before a decision is made by the court and judgment is entered. In May 2003, we filed a motion to certify the record for interlocutory appeal to the U.S. Federal Circuit Court of Appeals and Ciena filed motions for entry of judgment and for a permanent injunction, all of which are pending. In February 2004, our motion requesting a jury trial on a pending infringement issue was denied and we filed a Writ of Mandamus with the U. S. Federal Circuit Court of Appeals requesting that a retrial be ordered.

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We have designed our products in an effort to respect the intellectual property rights of others. We intend to continue to defend ourselves vigorously against these claims and pursue post-trial relief and appellate review of the trial proceedings, as necessary. While we believe that we will ultimately prevail in this litigation, there can be no assurance that we will be successful in the defense of the litigation.

We may consider settlement due to the costs and uncertainties associated with litigation in general, and patent infringement litigation in particular, and due to the fact that an adverse determination in the litigation could preclude us from producing some of our products until we were able to implement a non-infringing alternative design to any portion of our products to which such a determination applied. Even if we consider settlement, there can be no assurance that we will be able to reach a settlement with Ciena.

A final adverse determination in, or settlement of, the Ciena litigation could involve the payment of significant amounts by us, or could include terms in addition to payments, such as an injunction preventing the sale of infringing products and/or a redesign of some of our products, which could have a material adverse effect on our business, financial condition or results of operations. While management believes that we will ultimately prevail, we cannot be certain that the interim jury verdicts of infringement will be overturned, or that infringement of other patents in the suit will not be found in later legal proceedings. We expect that Ciena will attempt to use the interim jury verdicts and the possibility of an injunction to disrupt our sales efforts and customer relationships. To the extent it is necessary, a trial to determine damages will be held following any appeals. Such appeals can take up to a year or more before final determination.

We believe that the continuing defense of the lawsuit may be costly and may divert the time and attention of some members of our management. Further, Ciena and other competitors may use the continuing existence of the Ciena lawsuit to raise questions in customers' and potential customers' minds as to our ability to manufacture and deliver our products. There can be no assurance that questions raised by Ciena and others will not disrupt our existing and prospective customer relationships.

Class Action Suit

Between May 7, 2001 and June 15, 2001, nine class action lawsuits were filed in the United States District Court for the Southern District of New York relating to our initial public offering on behalf of all persons who purchased our stock between July 28, 2000 and the filing of the complaints. Each of the complaints named as defendants: Corvis, our directors and officers who signed the registration statement in connection with our initial public offering along with 309 other defendants, and certain of the underwriters that participated in our initial public offering. Our directors and officers have since been dismissed from the case, without prejudice. The complaints allege that the registration statement and prospectus relating to our initial public offering contained material misrepresentations and/or omissions in that those documents did not disclose (1) that certain of the underwriters had solicited and received undisclosed fees and commissions and other economic benefits from some investors in connection with the distribution of our common stock in the initial public offering and (2) that certain of the underwriters had entered into arrangements with some investors that were designed to distort and/or inflate the market price for our common stock in the aftermarket following the initial public offering. The complaints ask the court to award to members of the class the right to rescind their purchases of Corvis common stock (or to be awarded rescissory damages if the class member has sold its Corvis stock) and prejudgment and post-judgment interest, reasonable attorneys' and experts witness' fees and other costs.

By order dated October 12, 2001, the court appointed an executive committee of six plaintiffs' law firms to coordinate their claims and function as lead counsel. Lead plaintiffs have been appointed in almost all of the IPO allocation actions, including the Corvis action. On April 19, 2002, plaintiffs filed amended complaints in each of the IPO allocation actions, including the Corvis action. On February 19, 2003, the issuer defendants' motion to dismiss was granted with regard to certain claims and denied with regard to certain other claims. As to the Company, the Section 10(b) and Rule 10b-5 claims, alleging that we participated in a scheme to defraud investors by artificially driving up the price of the securities, were dismissed with prejudice, but the Section 11 claims, alleging that the registration statement contained a material misstatement of, or omitted, a material fact at the time it became effective, survived the motion to dismiss. On June 26, 2003, the plaintiffs' executive committee announced a proposed settlement between plaintiffs, on the one hand, and the issuer defendants and their respective officer and director defendants, including us and our named officers and directors, on the other. A memorandum of

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understanding to settle plaintiffs' claims against the issuers and their directors and officers has been approved by each of the 309 issuer defendants, including the Company. The settlement agreement is currently being prepared by the parties but has not yet been entered into. The proposed settlement is also subject to approval by the district court. The principal components of the proposed settlement include (i) a release of all of plaintiffs' claims against the issuer defendants and their officers and directors which have, or could have, been asserted in this litigation arising out of the conduct alleged in the amended complaints to be wrongful, (ii) the assignment by the issuers to the plaintiffs of certain potential claims against the underwriter defendants and the agreement by the issuers not to assert certain claims against the underwriter defendants, and (iii) an undertaking by the insurers of the issuer defendants to pay to plaintiffs the difference (the Recovery Deficit) between $1 billion and any lesser amount recovered from the underwriter defendants in this litigation. If recoveries in excess of $1 billion are obtained by plaintiffs from the underwriters, the insurers of the settling issuer defendants will owe no money to the plaintiffs. The proposed settlement does not resolve plaintiffs' claims against the underwriter defendants. While it is possible that the underwriter defendants and the plaintiffs may settle their claims eventually, pre-trial activity continues, including the selection by the plaintiffs of five issuer test cases on which to determine certain class certification matters. We have been selected as one of the five issuer test cases for that matter. However, per the terms of the proposed settlement, we do not anticipate that our continued involvement as a test case regarding this matter or any other, will result in any additional liability for us. We cannot be certain that we will not be subject to additional claims in the future, including claims brought by the underwriter defendants still involved in the litigation. These investigations could result in substantial costs and a diversion of management's attention and may have a material adverse effect on our business, financial condition and results of operations.

Qwest Investigations

The Denver, Colorado regional office of the SEC is conducting two investigations titled In the Matter of Qwest Communications International, Inc. and In the Matter of Issuers Related to Qwest. We believe the first of these investigations does not involve any allegation of wrongful conduct on the part of Corvis. In connection with the second investigation, the SEC is examining various transactions and business relationships involving Qwest and eleven companies having a vendor relationship with Qwest, including Corvis and has conducted interviews with certain of our current and former officers and employees. This investigation, insofar as it relates to Corvis, appears to focus generally on whether Corvis' transactions and relationships with Qwest and its employees were appropriately disclosed in Corvis' public filings and other public statements.

In addition, the United States Attorney in Denver is conducting an investigation involving Qwest, including Qwest's relationships with certain of its vendors, including Corvis. In connection with that investigation, the U.S. Attorney has sought documents and information from Corvis and has conducted interviews from persons associated or formerly associated with Corvis, including certain Corvis officers. The U.S. Attorney has indicated that, while aspects of its investigation are in an early stage, neither Corvis nor any of its current or former officers or employees is a target or a subject of the investigation.

Corvis is cooperating fully with these investigations. Corvis is not able, at this time, to determine when the SEC and/or U.S. Attorney investigations will be completed and resolved, or what the ultimate outcome with respect to Corvis will be. These investigations could result in substantial cost and a diversion of management's attention that may have a material adverse effect on our business, financial condition and results of operations.

Other

We and our subsidiaries from time to time are also subject to pending and threatened legal action and proceedings arising in the ordinary course of business. Management believes that the outcome of such actions and proceedings will not have a material adverse effect on the Company's business, financial condition or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

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PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters.

Our common stock was traded on the Nasdaq National Market under the symbol "CORV" from July 27, 2000 until October 13, 2002. From October 14, 2002 until September 12, 2003, our common stock was traded on the Nasdaq Small Cap Market under the symbol "CORV". Since September 15, 2003, our common stock has been traded on the Nasdaq National Market. The following table sets forth, for the periods indicated, the high and low bid information as reported on the Nasdaq National Market or the Nasdaq Small Cap Market for our common stock.

	High	Low
Fiscal 2002		
First Quarter (ended March 30, 2002)	$3.44	$1.08
Second Quarter (ended June 29, 2002)	$1.44	$0.64
Third Quarter (ended September 28, 2002)	$0.82	$0.51
Fourth Quarter (ended December 28, 2002)	$1.02	$0.47
Fiscal 2003		
First Quarter (ended March 29, 2003)	$0.95	$0.47
Second Quarter (ended June 30, 2003)	$1.75	$0.57
Third Quarter (ended September 30, 2003)	$2.09	$1.14
Fourth Quarter (ended December 31, 2003)	$1.81	$1.28

As of February 28, 2004, there were 484,157,929 holders of record of our common stock.

Dividend Policy

We have never paid or declared any cash dividends on our common stock or other securities and do not anticipate paying cash dividends in the foreseeable future. Any future determination to pay cash dividends will be at the discretion of our Board of Directors and will be dependent upon our financial condition, results of operations, capital requirements, general business conditions and such other factors as our Board of Directors may deem relevant.

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Item 6. Selected Financial Data.

You should read the following selected consolidated financial data along with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the notes to those statements included in "Item 8. Financial Statements and Supplementary Data." Operating results for historical periods are not necessarily indicative of the results that may be expected for future periods. During 1999, we changed our accounting reporting cycle from a calendar year-end to a 52- or 53-week fiscal year-end, ending on the Saturday closest to December 31 in each year. During 2003, we changed our accounting reporting cycle to a calendar year-end which did not result in a significant impact on our financial results.

	Year Ended				
	January 1, 2000	December 30, 2000	December 29, 2001	December 28, 2002	December 31, 2003
	(in thousands except per share data)				
Statement of Operations Data:					
Revenue:					
Communications services	$ —	$ —	$ —	$ —	$ 310,175
Equipment	—	68,898	188,450	20,208	4,139
Total revenue	—	68,898	188,450	20,208	314,314
Operating expenses:					
Cost of revenue:					
Communications services (excluding depreciation and amortization)	—	—	—	—	231,983
Equipment	—	42,943	333,487	84,884	33,036
Total cost of revenue	—	42,943	333,487	84,884	265,019
Research and development, excluding equity-based expense	39,674	84,161	127,795	97,372	46,802
Sales, general and administrative, excluding equity-based expense	21,739	59,810	84,818	71,308	151,735
Depreciation	2,567	6,900	27,615	35,301	34,529
Amortization of intangible assets	173	46,746	125,940	18,491	6,913
Equity-based expense	4,971	98,358	98,807	65,400	20,597
Restructuring and other charges	—	—	789,242	124,825	59,381
Purchased research and development	—	42,230	—	34,580	—
Total operating expenses	69,124	381,148	1,587,704	532,161	584,976
Operating loss	(69,124)	(312,251)	(1,399,254)	(511,953)	(270,662)
Other income (expense), net	(2,146)	28,640	21,161	4,193	9,804
Net loss before minority interest	(71,270)	(283,611)	(1,378,093)	(507,760)	(260,858)
Minority interest	—	—	—	—	387
Net loss	$(71,270)	$ (283,611)	$(1,378,093)	$ (507,760)	$ (260,471)
Basic and diluted net loss per common share	$ (2.33)	$ (1.80)	$ (3.94)	$ (1.30)	$ (0.60)
Weighted average number of common shares outstanding	30,599	157,349	349,652	392,012	430,596

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	As of				
	January 1, 2000	December 30, 2000	December 29, 2001	December 28, 2002	December 31, 2003
			(in thousands)		
Balance Sheet Data:					
Cash and cash equivalents	$ 244,597	$1,024,758	$ 638,872	$ 457,833	$ 256,490
Short-term and long-term investments	—	—	21,907	46,583	40,332
Working capital	236,839	1,172,040	726,505	459,843	253,601
Total assets	307,279	2,381,836	978,825	610,318	528,615
Notes payable and capital lease obligations, net of current portion	38,771	45,909	4,702	2,746	2,500
Redeemable stock	—	30,000	—	—	—
Total stockholders' equity	$ 239,625	$2,186,593	$ 888,853	$ 540,078	$ 397,669

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

You should read the following discussion and analysis along with our consolidated financial statements and the notes to those statements included elsewhere in this report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of various factors including the risks discussed in "Factors That May Affect Our Future Results" below and elsewhere in this report.

Overview

Corvis Corporation operates two divisions that serve different elements within the communications industry. Our communications services division, acquired on June 13, 2003 and managed within our Broadwing Communications, LLC subsidiary ("Broadwing"), delivers data and Internet, broadband transport and voice communications services nationwide. Our equipment division designs, manufactures and sells high performance all-optical and electrical/optical communications systems that we believe accelerate carrier revenue opportunities and lower the overall cost of network ownership for carriers.

Until the Broadwing acquisition, the Corvis equipment division was the primary focus of our capital investment and the sole source of our revenues. Due to significant declines in the opportunities within the communications equipment market, the communications services division is now our major focus of capital investment for the Company. Revenues from the communications services division will account for most of Corvis' revenues for the foreseeable future. Reflecting our realigned business focus, the communications services division comprised 99% of total revenue for fiscal year 2003, while the remaining 1% is attributable to equipment sales. Our equipment division has been restructured through staff reductions and other consolidation efforts that were completed in late 2003. The full effect of these cost reductions will be reflected starting in 2004. Our equipment division continues to service the networks of our existing customers, maintains certain centralized business operations and supports our Broadwing network. Because our consolidated results of operations only include the results of Broadwing since the acquisition date, the consolidated results of operations are not comparable to prior or future years.

Communications Services

On February 23, 2003, we entered into an agreement to invest approximately $129 million, including acquisition costs, for most of the assets and certain of the liabilities of Broadwing Communications Services, Inc. This purchase price was subject to a pre-closing reduction of up to $14.3 million if Broadwing Communications Services, Inc. failed to reach certain revenue and EBITDA targets it had established, and a post-closing reduction of an additional $10 million if certain EBITDA targets were not reached in a one-year period after the closing. The agreement also committed Broadwing Communications Services, Inc. to make capital expenditures of $3.0 million each month, consistent with its financial plan. On June 6, 2003, the parties agreed to reduce the purchase price by $7.2 million due to failure to meet the revenue target and by an additional $7.2 million for failure to achieve the targeted reduction in negative cash EBITDA, as defined in the agreement. An additional reduction in the purchase price of approximately $23 million was negotiated to reflect the seller's desire to forego making additional required capital expenditures, such as equipment and network upgrades, and to accelerate the closing of the transaction. These reductions reduced the purchase price to $92.9 million, including acquisition costs. The Broadwing acquisition closed on June 13, 2003. Subsequently in November 2003, the parties agreed on an additional post-closing reduction in the purchase price to $81.1 million, as negotiated pursuant to working capital and receivable adjustment obligations set forth in the agreement.

Broadwing provides communications services to large enterprises, mid-market business and other communications service provider customers over a a nationwide facilities based network connecting 137 cities nationwide. We believe that Broadwing's network and growth oriented strategy will enable Broadwing to compete effectively in the markets in which it operates. Broadwing 's optical network, capable of transmitting up to 800 Gbs per fiber, gives customers the benefit of high quality, technologically advanced solutions allowing for rapid provisioning, and highly flexible customized networking.

At the date of acquisition, Corvis owned a 96% interest and appointed 4 of the 6 board members of a holding company, which in turn owned Broading Communications, LLC. Cequel III, LLC ("Cequel") contributed approximately $0.9 million for a 1% ownership interest

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and the ability to appoint 2 of the 6 holding company board members. Cincinnati Bell, previously the parent company of Broadwing Communications Services, Inc., retained a 3% non-voting equity interest. In addition, we entered into a management services agreement with Cequel under which Cequel would manage Broadwing.

On November 20, 2003, we acquired Cequel's one percent equity stake and additional interests in Broadwing and terminated our management services agreement in exchange for a combination of cash and Corvis equity. In addition, we entered into a new master network services agreement to provide Cequel services at prices ranging from cost reimbursement to current market pricing. As a result of this agreement, we recorded restructuring charges of $18.5 million in the fourth quarter of 2003.

The Broadwing purchase price has been allocated to the assets and liabilities acquired on a preliminary basis and may change as additional information becomes available. The following table summarizes the preliminary purchase price allocation (in thousands).

Current assets	$ 83,300
Property plant and equipment	86,342
Intangible assets	27,160
Other long-term assets	7,400
Total assets acquired	204,202
Current liabilities	101,095
Long-term liabilities	21,095
Total liabilities assumed	122,190
Minority interest	915
Purchase price	$ 81,097

As part of the acquisition, the Company reduced its warranty reserve for that portion associated with previous equipment sales to Broadwing.

In February 2004, Corvis signed an agreement to acquire Focal Communications Corporation ("Focal"), a Chicago-based competitive local exchange carrier that provides voice and data solutions to enterprises, carriers and resellers for total consideration of $210 million, which will be comprised of approximately $101 million in equity to be issued to Focal's equity holders and the assumption or payment of approximately $109 million of Focal's existing debt and other long-term capital lease obligations. Focal operates in 23 Tier 1 markets from Boston to Miami and New York to Los Angeles, owns metro fiber footprint in nine Tier 1 national markets and maintains a 4,000 enterprise and wholesale/carrier customer base.

Corvis Equipment

Starting in 2001 and continuing through 2003, conditions within the general economy and communications sector in particular have resulted in reduced capital expenditures by carriers and a reduced demand for communications networking systems. These declines have had a severe adverse impact on our equipment revenue and results of operations. We cannot predict when or if market conditions will improve.

In response to these conditions, we have implemented a series of restructuring initiatives within our equipment division designed to decrease our business expenses and to conserve our resources. These actions included staff reductions, facility consolidations and the curtailment of discretionary spending. These restructuring plans have been reflected in our results of operations in 2001, 2002 and 2003. These plans are ongoing and will be reflected in our results of operations in the next quarter and beyond, as necessary. Our equipment division is now focused strategically on selective engagements with customers, including the U.S. government, servicing the networks of our existing customers, maintaining certain centralized business operations and supporting the Broadwing network.

In 2000, prior to the acquisition, Broadwing Communications Services, Inc. agreed to purchase our ON products and services as part of a multi-year purchase agreement. Since successfully completing field trials in July

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2000, Broadwing Communications Services, Inc. deployed a wide range of our optical networking products, including our all-optical switch, to create a national all-optical network that has been in service for over three years. Prior to the acquisition, Broadwing was our largest customer representing sales of $114.2 million, $8.7 million and $0.5 million in 2001, 2002 and 2003, respectively. As a result of the Broadwing acquisition, future equipment revenues from sales to Broadwing will be eliminated in the consolidated financial statements.

In 2001, Wiltel Communications Group, Inc. (formerly Williams Communications, LLC) accepted a field trial system and agreed to purchase our optical networking products and services as part of a multi-year purchase agreement. Wiltel has deployed our integrated switching and transport equipment in their national network, which is currently in service carrying commercial traffic. Revenues attributable to Wiltel were $74.2 million and $1.0 million in 2001 and 2002, respectively. Purchase commitments totaling approximately $7.4 million remain under the Wiltel agreement, however, we are in discussions with Wiltel which could result in, among other things, reductions or elimination of this amount.

On April 22, 2002, we reached an agreement with Qwest Communications Corporation ("Qwest") modifying the terms of previous agreements to purchase our products and services over a multi-year period. During 2002, we recognized revenue of $7.0 million under this agreement. During the fourth quarter of 2002, we reached an agreement with Qwest in which Qwest would purchase approximately $2.6 million of our equipment, subject to certain acceptance criteria and would pay $1.2 million in settlement of all remaining purchase obligations. We expect to recognize revenue associated with equipment sales to Qwest in the first half of 2004.

In the third quarter of 2002, we created a wholly owned subsidiary, Corvis Government Solutions, Inc., to provide optical networking solutions to the U.S. Federal Government. During the third quarter of 2002, Corvis Government Solutions secured its first contract and purchase order from the U.S. Federal Government for a limited field trial, which was accepted in the first quarter of 2003.

Most of our equipment customers have met or are approaching contractual minimum purchase commitments. We do not expect material sales of our ON product in the foreseeable future. While we do expect sales of our OCS product to the U.S. government and other customers, these sales will likely be at levels that are consistent with 2003 activities.

Critical Accounting Policies

We have identified the following critical accounting policies that affect the more significant judgments and estimates used in the preparation of our consolidated financial statements. Some of these policies were adopted upon the Broadwing acquisition. The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect our reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to inventory obsolescence, asset impairment, revenue recognition, product warranty liabilities, allowance for doubtful accounts, and contingencies and litigation. We state these accounting policies in the notes to annual consolidated financial statements (see Item 8) and at relevant sections in this discussion and analysis. These estimates are based on the information that is currently available to us and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could vary from those estimates under different assumptions or conditions and the variances could be material.

Revenue Recognition

Communications Services. Switched services are billed monthly in arrears, while the revenue is recognized as the services are provided. Customers are billed in advance for month-to-month dedicated network services including certain data and broadband transport, while associated revenue is deferred and recognized as the services are provided. Indefeasible right-of-use, or IRU, agreements represent the lease of network capacity or dark fiber and are recorded as deferred revenue at the earlier of the acceptance of the applicable portion of the network by the customer or the receipt of cash. The buyer of IRU services typically pays cash upon execution of the contract, and the associated IRU revenue is then recognized over the life of the agreement as services are provided, beginning on the date of customer acceptance. In the event the buyer of an IRU terminates a contract prior to the contract expiration and releases us from the obligation to provide future services, the remaining unamortized deferred revenue is recognized in the period in which the contract is terminated. Fees billed in connection with a service installation are deferred and recognized ratably over estimated contract lives.

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Equipment sales and services. Revenue from equipment sales is recognized upon execution of a contract and the completion of all delivery obligations provided that there are no uncertainties regarding customer acceptance and collectibility is deemed probable. If uncertainties exist, revenue is recognized when such uncertainties are resolved. Customer contracts generally include extensive lab and field trial testing and some include other acceptance criteria.

Allowance for Bad Debt

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We determine the estimate of the allowance for doubtful accounts based on a variety of factors including the length of time receivables are past due, the financial health of customers, and historical experience. If the financial condition of our customers were to deteriorate or other circumstances occur that result in an impairment of customers' ability to make payments, additional allowances may be required.

Asset Impairment and Other Charges

Reflecting continued unfavorable economic conditions and continued lack of expected equipment sales, our board of directors approved plans from 2001 through 2003 for the restructuring of equipment division operations including the consolidation of facilities, reduction in the number of employees and the outsourcing of a majority of our manufacturing capabilities. These decisions, as well as reductions in projected sales and cash flows, have resulted in various asset impairment charges, which are based on recoverability estimates and estimated fair values. If actual market conditions are less favorable than those projected by management or if events occur or circumstances change that would reduce the estimated recoverability of our assets, additional restructuring and impairment charges may be required.

Intangible Assets

We have recorded intangible assets resulting from our acquisitions. We account for goodwill and other intangible assets under SFAS No. 142, "*Goodwill and Other Intangible Assets*." SFAS 142 requires that goodwill and other intangible assets with an indefinite life will be tested for impairment at least annually. The impairment test is a two-step process that requires goodwill to be allocated to reporting units. In the first step, the fair value of the reporting unit is compared with the carrying value of the reporting unit. If the fair value of the reporting unit is less than the carrying value of the reporting unit, an impairment may exist, and the second step of the test is performed. In the second step, the fair value of the intangible asset is compared with the carrying value, and an impairment loss will be recognized to the extent that the carrying value exceeds the fair value.

We are required to review the recoverability of our goodwill and other intangible assets with indefinite lives, at least annually. If actual market conditions are less favorable than those projected by management or if events occur or circumstances change that would reduce the estimated recoverability of these assets, impairment charges may be required.

Litigation

In July 2000, Ciena Corporation ("Ciena") informed us of its belief that there is significant correspondence between products that we offer and several U.S. patents held by Ciena relating to optical networking systems and related dense wavelength division multiplexing ("WDM") communications systems technologies. In general, the technologies at issue involve how some of our equipment is used to transmit and receive communication signals between two points in the network. On July 19, 2000, Ciena filed a lawsuit in the United States District Court for the District of Delaware alleging that we are willfully infringing three of Ciena's patents relating to dense wavelength division multiplexing communications technologies. On March 5, 2001, a motion was granted allowing Ciena to amend its complaint to include allegations that we are willfully infringing two additional patents. One patent was dropped from the litigation by agreement of the parties prior to trial. In February 2003, jury trials were held on the issues of infringement and invalidity of the four patents. Our all-optical networking products were found not to

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infringe two of Ciena's WDM patents. The jury did not reach a verdict on a third Ciena WDM patent, which is related to the two non-infringed WDM patents. Corvis' OC-192 inverse multiplexing transceiver product, which can generally be described as a device that separates higher speed signals into lower speed signals for transmission and then recombines the lower speed signals after transmission that can be used along with our all-optical networking products, was found by the jury to infringe a Ciena patent on bit rate transparent devices. In an April 2003 retrial, the manner in which certain Corvis OC-48 transmitters and receivers convert the signals from optical form to an electronic form and back again, in a WDM system was found by a jury to infringe the patent, upon which a jury verdict was not reached in the February 2003 trial. The jury verdicts to date are interim verdicts, in so far as additional trial court proceedings remain before a decision is made by the court and judgment is entered. In May 2003, we filed a motion to certify the record for interlocutory appeal to the U.S. Federal Circuit Court of Appeals and Ciena filed motions for entry of judgment and for a permanent injunction, all of which are pending. In February 2004, our motion requesting a jury trial on a pending infringement issue was denied and we filed a Writ of Mandamus with the U.S. Federal Circuit Court of Appeals requesting that a retrial be ordered.

While management believes that we will ultimately prevail, we cannot be certain that the interim jury verdicts of infringement will be overturned, or that infringement of other patents in the suit will not be found in later legal proceedings. We expect that Ciena will attempt to use the interim jury verdicts and the possibility of an injunction to disrupt our equipment sales efforts and customer relationships. To the extent it is necessary, a trial to determine damages will be held following any appeals. Such appeals can take up to a year or more before final determination. Based on the current status of the litigation, we cannot reasonably predict the likelihood of any final outcome.

Between May 7, 2001 and June 15, 2001, nine class action lawsuits were filed in the United States District Court for the Southern District of New York relating to our initial public offering on behalf of all persons who purchased our stock between July 28, 2000 and the filing of the complaints. Each of the complaints named as defendants: Corvis, our directors and officers who signed the registration statement in connection with our initial public offering, and certain of the underwriters that participated in our initial public offering. Our directors and officers have since been dismissed from the case, without prejudice. The complaints allege that the registration statement and prospectus relating to our initial public offering contained material misrepresentations and/or omissions in that those documents did not disclose (1) that certain of the underwriters had solicited and received undisclosed fees and commissions and other economic benefits from some investors in connection with the distribution of our common stock in the initial public offering and (2) that certain of the underwriters had entered into arrangements with some investors that were designed to distort and/or inflate the market price for our common stock in the aftermarket following the initial public offering. The complaints ask the court to award to members of the class the right to rescind their purchases of Corvis common stock (or to be awarded rescissory damages if the class member has sold its Corvis stock) and prejudgment and post-judgment interest, reasonable attorneys' and experts witness' fees and other costs.

By order dated October 12, 2001, the court appointed an executive committee of six plaintiffs' law firms to coordinate their claims and function as lead counsel. Lead plaintiffs have been appointed in almost all of the IPO allocation actions, including the Corvis action. On April 19, 2002, plaintiffs filed amended complaints in each of the IPO allocation actions, including the Corvis action. On February 19, 2003, the issuer defendants' motion to dismiss was granted with regard to certain claims and denied with regard to certain other claims. As to the Company, the Section 10(b) and Rule 10b-5 claims, alleging that the Company participated in a scheme to defraud investors by artificially driving up the price of the securities, were dismissed with prejudice, but the Section 11 claims, alleging that the registration statement contained a material misstatement of, or omitted, a material fact at the time it became effective, survived the motion to dismiss. On June 26, 2003, the plaintiffs' executive committee announced a proposed settlement between plaintiffs, on the one hand, and the issuer defendants and their respective officer and director defendants, including the Company and its named officers and directors, on the other. A memorandum of understanding to settle plaintiffs' claims against the issuers and their directors and officers has been approved by each of the 309 issuer defendants, including the Company. The settlement agreement is currently being prepared by the parties but has not yet been entered into. The proposed settlement is also subject to approval by the district court. The principal components of the proposed settlement include (i) a release of all of plaintiffs' claims against the issuer defendants and their officers and directors which have, or could have, been asserted in this litigation arising out of the conduct alleged in the amended complaints to be wrongful, (ii) the assignment by the issuers to the plaintiffs of certain potential claims against the underwriter defendants and the agreement by the issuers not to assert certain claims against the underwriter defendants, and (iii) an undertaking by the insurers of the issuer defendants to pay to plaintiffs the difference (the Recovery Deficit) between $1 billion and any lesser amount recovered from the underwriter defendants in this litigation. If recoveries in excess of $1 billion are obtained by plaintiffs from the

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underwriters, the insurers of the settling issuer defendants will owe no money to the plaintiffs. The proposed settlement does not resolve plaintiffs' claims against the underwriter defendants. While it is possible that the underwriter defendants and the plaintiffs may settle their claims eventually, pre-trial activity continues, including the selection by the plaintiffs of five issuer test cases on which to determine certain class certification matters. We have been selected as one of the five issuer test cases for that matter. However, in accordance with the terms of the proposed settlement, we do not anticipate that our continued involvement as a test case regarding this matter or any other, will result in any additional liability for the Company. We cannot be certain that we will not be subject to additional claims in the future, including claims brought by the underwriter defendants still involved in the litigation.

The Denver, Colorado regional office of the SEC is conducting two investigations titled In the Matter of Qwest Communications International, Inc. and In the Matter of Issuers Related to Qwest. We believe the first of these investigations does not involve any allegation of wrongful conduct on the part of Corvis. In connection with the second investigation, the SEC is examining various transactions and business relationships involving Qwest and eleven companies having a vendor relationship with Qwest, including Corvis and has conducted interviews with certain current and former officers and employees. This investigation, insofar as it relates to Corvis, appears to focus generally on whether Corvis' transactions and relationships with Qwest and its employees were appropriately disclosed in Corvis' public filings and other public statements.

In addition, the United States Attorney in Denver is conducting an investigation involving Qwest, including Qwest's relationships with certain of its vendors, including Corvis. In connection with that investigation, the U.S. Attorney has sought documents and information from Corvis and has conducted interviews from persons associated or formerly associated with Corvis, including certain Corvis officers. The U.S. Attorney has indicated that, while aspects of its investigation are in an early stage, neither Corvis nor any of its current or former officers or employees is a target or a subject of the investigation.

Corvis is cooperating fully with these investigations. Corvis is not able, at this time, to say when the SEC and/or U.S. Attorney investigations will be completed and resolved, or what the ultimate outcome with respect to the Company will be. These investigations could result in substantial costs and a diversion of management's attention that may have a material adverse effect on our business, financial condition and results of operations.

We and our subsidiaries from time to time are also subject to pending and threatened legal action and proceedings arising in the ordinary course of business. Management believes that the outcome of such actions and proceedings will not have a material adverse effect on the Company's business, financial condition or results of operations.

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Results of Operations

Selected financial data (in thousands):

	Year Ended				
			December 31, 2003		
	December 29, 2001	December 28, 2002	Equipment	Communications Services	Total
Revenue:					
Communications services	$ —	$ —	$ —	$ 310,175	$ 310,175
Equipment	188,450	20,208	4,139	—	4,139
Total revenue	188,450	20,208	4,139	310,175	314,314
Operating expenses:					
Cost of revenue:					
Communications services	—	—	—	231,983	231,983
Equipment sales	333,487	84,884	33,036	—	33,036
Total cost of revenue	333,487	84,884	33,036	231,983	265,019
Research and development, excluding equity-based expense	127,795	97,372	46,802	—	46,802
Selling, general and administrative, excluding equity-based expense	84,818	71,308	37,483	114,252	151,735
Depreciation	27,615	35,301	18,884	15,645	34,529
Amortization	125,940	18,491	4,636	2,277	6,913
Equity-based expense	98,807	65,400	20,597	—	20,597
Restructuring and other charges	789,242	124,825	40,893	18,488	59,381
Purchased research and development	—	34,580	—	—	—
Operating loss	(1,399,254)	(511,953)	(198,192)	(72,470)	(270,662)
Other income (expense), net	21,161	4,193	9,934	(130)	9,804
Net loss before minority interest	(1,378,093)	(507,760)	(188,258)	(72,600)	(260,858)
Minority interest	—	—	—	387	387
Net loss	$(1,378,093)	$ (507,760)	$(188,258)	$ (72,213)	$(260,471)

Year ended December 31, 2003 compared to year ended December 28, 2002

Revenue. Revenue increased to $314.3 million for the fiscal year ended December 31, 2003 from $20.2 million for the fiscal year ended December 28, 2002 principally due to the inclusion of $310.2 million of Broadwing communications services revenue earned after the June 13, 2003 acquisition through year end.

Communications Services Revenue.

Communications services revenue consists of the sale of data and Internet, broadband transport and voice communication services. Data and Internet sales consist of high-speed data transport utilizing technology based on Internet protocol ("IP") and ATM/frame relay. Broadband transport services consist of long-haul transmission of data, voice and Internet traffic over dedicated circuits. Voice services consist of dedicated and billed minutes of use; primarily for the transmission of voice long distance services on behalf of wholesale and retail customers. A summary of communications services revenue is as follows:

	Quarter Ended			
	June 30, 2003*	September 30, 2003	December 31, 2003	Total
Data and internet services	$ 6,090	$ 34,053	$ 34,037	$ 74,180
Broadband transport	10,586	56,272	57,136	123,994
Voice services	10,021	52,799	49,181	112,001

Total communications services revenue	$26,697	$ 143,124	$ 140,354	$310,175

* Includes revenues beginning on the date of acquisition, June 13, 2003.

Communications services revenues totaled $310.2 million for the fiscal year ended December 31, 2003 reflecting two full quarters of Broadwing operations. Prior to the acquisition, Broadwing Communications Services, Inc. revenues had declined substantially as a result of the downturn within the communications industry and intense price competition. Since the date of acquisition and with consideration to seasonality from varying business days within each reporting period, we have seen a stabilization in the decline of revenue in data and Internet,

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broadband transport and voice services. Competition and pricing pressures continue to affect Broadwing in all of its product lines. To address these issues, we focus our efforts on selling higher margin products to larger customers with complex communications needs, developing new products that differentiate Broadwing from its competition and reducing incremental service costs to allow us to better compete on the sale of price sensitive products.

Significant portions of Broadwing Communication Services, Inc.'s historical revenues were generated through indefeasible right-of-use agreements ("IRU"), whereby the customer leases network capacity or dark fiber. The buyer of IRU services typically pays cash upon the execution of the contract and the associated revenue is deferred and then recognized over the life of the agreement. At the date of acquisition, the Company recorded the deferred revenue associated with acquired IRU contracts at fair value, which was substantially less than historical book value. As a result, the Company expects that revenues from IRU's will be significantly less than those previously reported by Broadwing Communications Services, Inc. IRU revenues totaled $3.3 million for the year ended December 31, 2003.

Equipment Revenues. Equipment revenue decreased to $4.1 million for the fiscal year ended December 31, 2003 from $20.2 million for the fiscal year ended December 28, 2002, reflecting a continued decrease in the volume of equipment sales. Most of our customers have met or are approaching contractual minimum purchase commitments. A significant portion of our future revenue will therefore depend on the amount and timing of new firm order commitments from existing customers, as well as new contract wins. Given our historical declines in equipment sales and the focus of our investment away from our equipment division, revenues associated with the sale of our equipment and services will likely remain at current or lower levels for the next quarter and beyond.

Cost of Revenues. Cost of revenues increased to $265.0 million for the fiscal year ended December 31, 2003 from $84.9 million for the fiscal year ended December 28, 2002 principally due to the inclusion of approximately $232.0 million for Broadwing communications services costs of revenue incurred after the June 13, 2003 acquisition through year end.

Communications Services Cost of Revenue. Communications services cost of revenue primarily reflects access charges paid to local exchange carriers and other providers and transmission lease payments to other carriers. Communications services cost of revenue totaled $232.0 million for the fiscal year ended December 31, 2003, reflecting operations for the period June 13, 2003 through December 31, 2003. During the third quarter of 2003, we began making capital expenditures associated with our network assets in the form of fiber and equipment purchases designed to reduce the access charges we incur. During this process, our cost of sales may increase due to one-time charges as we transition to lower cost network alternatives. There can be no assurance, however, as to the amount or timing of the cost savings we are attempting to achieve.

Equipment Cost of Revenue. Equipment cost of revenue decreased to $33.0 million for the fiscal year ended December 31, 2003 from $84.9 million for the fiscal year ended December 28, 2002. Equipment cost of revenue consists of component costs, direct compensation costs, warranty and other contractual obligations, inventory obsolescence costs and manufacturing overhead including depreciation. As a result of our restructuring plans and excess inventories resulting from reduced capital expenditures by telecommunication carriers, we recorded inventory impairment charges as a cost of revenue totaling $31.2 million during 2003 and $68.8 million during 2002. At December 31, 2003, inventory balances relate principally to manufactured items built to fulfill firm customer orders. We do not anticipate inventory build-ups in excess of firm customer orders. As a result, we do not expect significant inventory impairment charges in the coming quarters.

Research and Development Expense, Excluding Equity-Based Expense. Research and development expense, all of which is included in our equipment division, excluding equity-based expense, consists primarily of personnel, material, laboratory and facilities costs related to the design of our hardware and software equipment products. All costs related to product development, both hardware and software, are recorded as expenses in the period in which they are incurred. Due to the timing and nature of the expenses associated with research and development, significant quarterly fluctuations may result.

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Research and development expenses, excluding equity-based expense, decreased to $46.8 million for the fiscal year ended December 31, 2003 from $97.4 million for the fiscal year ended December 28, 2002. The decrease in expense was primarily attributable to the effect of cost savings initiatives including staff reductions, facilities and equipment consolidation and the curtailment of certain discretionary spending. During 2003, we reduced our research and development staff from 519 to 105 employees. Remaining research and development efforts will be focused on a limited number of strategic initiatives. As a result, we expect research and development expense to be lower in future quarters.

Sales, General & Administrative, Excluding Equity-Based Expense. Sales, general & administrative expense, excluding equity-based expense, consists primarily of costs associated with personnel, travel, information systems support and facilities related to our sales, network operations, network engineering and administrative support functions. In addition, sales, general and administrative charges include laboratory trial systems provided to equipment customers and trade shows.

Sales, general and administrative expense, excluding equity-based expense, increased to $151.7 million for the fiscal year ended December 31, 2003 from $71.3 million for the fiscal year ended December 28, 2002. The increase was primarily due to the inclusion of approximately $114.3 million of sales, general and administrative expenses related to Broadwing since the acquisition date.

Depreciation expense. Depreciation expense decreased to $34.5 million for the fiscal year ended December 31, 2003 from $35.3 million for the fiscal year ended December 28, 2002. This decrease is primarily due to $107.7 million asset impairment charges recorded in fiscal year 2002, offset in part by an increase in depreciation associated with the Broadwing assets.

Amortization of Intangible Assets. Amortization of intangible assets expense decreased to $6.9 million for the fiscal year ended December 31, 2003 from $18.5 million for the fiscal year ended December 28, 2002. The decrease is attributable to declines in amortizable intangible assets in the equipment division due to previously recorded impairment charges. We record amortization expense associated with certain intangible assets with finite useful lives, such as acquired customer relationships and in-place contracts licenses with lives ranging from three to nine years.

Equity-based Expense. Equity-based expense consists primarily of charges associated with employee options granted at below fair market value.

Equity-based expense related to research and development and sales, general and administrative functions for the fiscal year ended December 31, 2003 decreased to $20.6 million from $65.4 million for the fiscal year ended December 28, 2002. The decrease in equity-based compensation resulted from a decrease in employee headcount within our equipment division. However, in 2003, the Company granted a number of employee incentive stock options with exercise prices below fair value. As a result, we recorded increased expense in the second half of 2003 and we expect these expenses to continue in the coming quarters.

Inventory write-downs, Restructuring and Other Charges. Starting in 2001 and continuing through 2003, conditions within the general economy and communications sector have resulted in reduced capital expenditures by carriers and a reduced demand for communications networking systems. These declines have had a severe adverse impact on Corvis equipment revenue and the results of operations within the equipment division. Management cannot predict when or if market conditions will improve.

In response to these conditions, our equipment division has been restructured through staff reductions and other consolidation efforts and is now focused strategically on selective customer engagements principally related to our OCS product. In addition, the equipment division continues to service the networks of existing customers, maintains certain centralized business operations and supports the Broadwing network. These restructuring plans have been reflected in the results of operations in 2001, 2002, and 2003, and management will continue to assess the need for additional restructurings in response to economic changes or strategic initiatives in the future.

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We are continually evaluating the recoverability of our long-lived assets in light of these initiatives and the projected economic and operating environment.

As a result, we recorded the following charges in 2002 and 2003 (in thousands):

	Year Ended	
	December 28, 2002	December 31, 2003
Equipment cost of sales—inventory write-downs and other	$ 68,785	$ 31,163
Restructuring, impairment and other charges:		
Workforce reductions and facilities consolidation	17,139	24,943
Valuation and impairment of long-lived assets	107,686	15,950
Contract termination charges—Communications Services Division	—	18,488
Total restructuring, impairment and other charges	124,825	59,381
Other income, net —impairment of strategic equity investments	4,978	385
Total restructuring and related charges	$ 198,588	$ 90,929

Equipment Cost of Sales—Inventory Write-downs and Other.

We write down inventory for estimated obsolete, excess and overvalued inventory based on estimated sales projections and market values. As a result of the decline in spending by communications carriers and the discontinuation of certain products, the Company recorded $68.8 million and $31.2 million in inventory write-downs and other related charges in 2002 and 2003, respectively.

Workforce Reductions and Facility Consolidation.

2002. During 2002, workforce reduction programs continued and resulted in the elimination of approximately 300 positions and $19.6 million in related charges. In addition, we recorded approximately $2.5 million associated with adjustments to reduce estimated facility consolidation accruals recorded in prior periods.

2003. During 2003, workforce reduction programs continued and resulted in the elimination of approximately 600 positions and charges of $15.6 million. In addition we recorded approximately $9.3 million associated with facility consolidation and the cumulative effect of the foreign currency impact associated with the shut down of our French operations and write-off of accumulated translation adjustment losses.

Valuation and Impairment of Long-lived Assets.

2002. SFAS 142 requires that goodwill be tested for impairment initially within one year of adoption (transitional test) and at least annually thereafter. The goodwill impairment test is a two-step process that requires goodwill to be allocated to reporting units. In the first step, the fair value of the reporting unit is compared with the carrying value of the reporting unit. If the fair value of the reporting unit is less than the carrying value of the reporting unit, a goodwill impairment may exist, and the second step of the test is performed. In the second step, the implied fair value of the goodwill is compared with the carrying value of the goodwill, and an impairment loss will be recognized to the extent that the carrying value of the goodwill exceeds the implied fair value of the goodwill.

If an impairment loss exists as a result of the transitional goodwill impairment test, the implementation of SFAS 142 could result in a one-time charge to earnings as a cumulative effect of an accounting change. In January 2002, the Company performed the transitional test and determined that no adjustment to carrying value was required.

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In performing the annual test in 2002, the Company determined the estimated fair value of its reporting units and compared it to the carrying value of the reporting unit. As a result of the comparison, there was an indication that a certain reporting unit's goodwill may have been impaired and the second step of the impairment test was performed.

In the second step, the Company compared the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill. The implied fair value of the goodwill was determined by allocating the fair value of the reporting unit to all of the assets and liabilities of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No. 141. The residual fair value after this allocation was the implied fair value of the reporting unit goodwill. As a result of the second step of the impairment test, in the fourth quarter of 2002, the Company recognized an impairment charge of approximately $15.5 million as a component of restructuring, impairment and other charges.

Also in 2002, the Company announced a multi-year manufacturing outsourcing agreement with Celestica, a provider of electronics manufacturing services. Under the agreement, the Company transitioned substantially all of its manufacturing capabilities to Celestica with the exception of final assembly, system integration and testing capabilities. In addition, the Company further reduced its headcount and operations as part of restructuring plans implemented during 2002. In connection with these restructuring initiatives, certain fixed assets were decommissioned and the recoverability of the long-lived assets still in use was reviewed. As a result, in the fourth quarter of 2002, we recorded charges totaling $92.2 million associated with the impairment of certain fixed assets, patents and intellectual property.

2003. In 2003, in light of projected market conditions associated with our equipment division, the Company performed an analysis as to the recoverability of our long-lived assets, using discounted projected cash flows for each reporting unit. As a result, we recorded a write-down of fixed assets totaling $6.7 million and a write-down of intangible assets totaling $9.3 million.

Cequel Contract Termination Charges

At the date of the Broadwing acquisition, Corvis owned a 96% interest and the ability to appoint 4 of the 6 board members in a holding company which in turn owned Broadwing Communications LLC. Cequel contributed approximately $0.9 million for a 1% ownership interest and the ability to appoint 2 of the 6 board members. Cincinnati Bell, previously the parent company of Broadwing Communications Services, Inc., retained a 3% non-voting equity interest. In addition, we entered into a management services agreement with Cequel under which Cequel would manage Broadwing.

On November 20, 2003, we acquired Cequel's one percent equity stake and additional interests and terminated the management services agreement. In aggregate, Corvis paid $2.9 million as a return of Cequel's initial investment, as final payment for services rendered, for termination of the Cequel management services agreement, and in exchange for ongoing consulting services. Corvis now owns 97% of the equity interest in Broadwing Communications and maintains 100% control, including the ability to appoint all 6 holding company board members. Cincinnati Bell continues to retain a 3% non-voting equity stake in Broadwing. As additional consideration, we also issued, and agreed to register with the Securities and Exchange Commission, 2.75 million shares of Corvis common stock to Cequel and granted them a warrant to purchase an additional 7.25 million shares at prices ranging from $1.37, the closing price on November 20, to $2.25 per share. As part of this agreement, Corvis entered into a 15-year network services agreement with Cequel in which the Company will provide network services at prices ranging from incremental cost reimbursement to current market pricing. In addition, Cequel agreed to provide certain consulting services to Corvis over the next four-years and will act as a non-exclusive sales agent for Broadwing products and services, for which they will receive sales commissions. Corvis recorded a charge in the fourth quarter of $18.5 million equal to the excess of the fair value of the cash, equity and services committed over the fair value of Cequel's ownership interest and services performed.

Strategic Equity Investments. In prior years, the Company made strategic equity investments in certain non-public startup companies totaling $17.6 million. These investments were carried at cost as the Company owns less than 20 percent of the voting equity and does not have the ability to exercise significant influence over these companies. During 2002 and 2003, the Company recorded charges totaling $4.9 million and $0.4 million, respectively, associated with the other than temporary impairment of these investments resulting from the impact of economic conditions on certain of these investees. The carrying value of these investments was fully impaired at December 31, 2003.

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Other income net. Other income, net increased to $9.8 million for the fiscal year ended December 31, 2003 from $4.2 million for the fiscal year ended December 28, 2002. The increase is attributable primarily to charges of approximately $5.0 million related to the write-down of strategic non-controlling equity investments in 2002 and $4.9 million from gains on the disposal of fixed assets, the settlement of certain insurance claims and settlement of certain claims with Qwest recognized in 2003, offset in part by a $5.5 million decrease in interest income due to lower average invested balances.

Year ended December 28, 2002 compared to year ended December 29, 2001

Revenue. Revenue decreased to $20.2 million for the fiscal year ended December 28, 2002 from $188.5 million for the fiscal year ended December 29, 2001. The decrease in revenue was attributable to a decrease in demand for optical communications systems. Revenue for the years ended 2002 and 2001 is attributable to five customers and two customers, respectively. In 2002, Broadwing Communications Services, Qwest Communications Corporation, Wiltel Communications Group, Inc. (formerly known as Williams Communications, LLC), Telefonica de Espana S.A.U., and France Telecom represented $8.7 million or 43% of total revenue, $7.0 million or 35% of total revenue, $1.0 million or 5% of total revenue, $2.3 million or 11% of total revenue, and $1.2 million or 6% of total revenue, respectively. In 2001, Broadwing and Wiltel represented $114.2 million or 61% of total revenue and $74.3 million or 39% of total revenue, respectively. Services, including customer support, installation and training, represented 28% and 5% of total revenue in 2002 and 2001, respectively.

Cost of sales . Cost of revenues decreased to $84.9 million for the fiscal year ended December 28, 2002 from $333.5 million for the fiscal year ended December 29, 2001, principally due to a decline in demand for our products and impairment charges associated with our restructuring initiatives.

Cost of revenue consists of component costs, direct compensation costs, warranty and other contractual obligations, inventory obsolescence costs and overhead related to our manufacturing and engineering, finishing and installation operations. As a result of discontinued product lines under our restructuring plans and excessive inventories due to reduced capital expenditures by communications carriers, we recorded cost of revenue charges totaling $68.8 million in 2002 and $216.5 million in 2001.

Research and Development, Excluding Equity-Based Expense. Research and development, excluding equity-based expense, consists primarily of salaries and related personnel costs, test and prototype expenses related to the design of our hardware and software products, laboratory costs and facilities costs. All costs related to product development, both hardware and software, are recorded as expenses in the period in which they are incurred. Due to the timing and nature of the expenses associated with research and development, significant quarterly fluctuations may result. We believe that research and development is critical in achieving current and future strategic product objectives.

Research and development expenses, excluding equity-based expense, decreased to $97.4 million for the year ended December 28, 2002 from $127.8 million for the year ended December 29, 2001. The decrease in expenses was primarily attributable to a reduction in prototype material usage.

Sales, General, and Administrative, Excluding Equity-Based Expense. Sales, general, and administrative, excluding equity-based expense, consists primarily of salaries and related personnel costs, laboratory trial systems provided to customers, trade shows, other marketing programs, executive, financial, legal, information systems and other administrative responsibilities.

Sales, general and administrative excluding equity-based expense, decreased to $71.3 million for the year ended December 28, 2002 from $84.8 million for the year ended December 29, 2001. The decrease in expenses was primarily attributable to a reduction in headcount and marketing and tradeshow programs offset, in part, by an increase in lab trial expenses.

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Depreciation expense. Depreciation expense increased to $35.3 million for the fiscal year ended December 28, 2002 from $27.6 million for the fiscal year ended December 29, 2001. The increase was primarily associated with a higher average depreciable asset base throughout the year.

Amortization of Intangible Assets. Historically, amortization of intangible assets primarily related to the amortization of goodwill associated with the acquisition of Algety Telecom S.A. As a result of the issuance of SFAS No. 142, we no longer record amortization of goodwill as of January 1, 2002. Under SFAS No. 142, goodwill is tested at least annually for impairment. Intangible assets that are separate and have finite useful lives, such as acquired patent rights and intellectual property licenses, continue to be amortized over their useful lives.

Amortization of intangible assets expenses decreased to $18.5 million for the year ended December 28, 2002 from $125.9 million for the year ended December 29, 2001. The decrease was primarily attributable to the discontinuation of amortization of goodwill under SFAS No. 142.

Equity-based Expense. Equity-based expenses consists primarily of charges associated with amortization of employee options granted at below fair market value prior to our initial public offering.

Equity-based expense related to research and development, sales and marketing and general and administrative functions for the year ended December 28, 2002 decreased to $65.4 million from $98.8 million for the year ended December 29, 2001. The decrease in equity-based compensation resulted from decreases in employee headcount.

Restructuring, Impairment and Other Charges. During 2001 and continuing in 2002, we developed and implemented restructuring plans designed to decrease our operating expenses and to align our resources for long-term growth opportunities. In addition, we evaluated the recoverability of our inventory and long-lived assets in light of these plans and the current and projected economic environment. As a result, we recorded the following charges (in thousands):

	Year Ended	
	December 29, 2001	December 28, 2002
Cost of sales—inventory write-down and other	$ 216,535	$ 68,785
Restructuring and other:		
Workforce and facility reductions	77,719	17,139
Valuation and impairment of long-lived assets, including goodwill	711,523	107,686
Total restructuring and other charges	789,242	124,825
Other charges—impairment of strategic equity investments	12,301	4,978
Total restructuring and impairment charges	$1,018,078	$ 198,588

Cost of Sales—Inventory Write-downs and Other. We write down our inventory for estimated obsolete, excess and overvalued inventory based on estimated sales projections and market values. As a result of the decline in spending by communications carriers and the discontinuation of certain products, we recorded $68.8 million in 2002 and $216.5 million in 2001 in inventory write-downs and other related charges.

Workforce Reductions and Facility Consolidation. During 2001, we initiated companywide workforce reduction programs that resulted in the elimination of approximately 650 positions and associated charges of approximately $24.5 million. In addition, we recorded approximately $53.2 million in charges associated with the cost of closing certain facilities.

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During 2002, workforce reduction programs continued including substantial reductions in our French operations and resulted in the elimination of approximately 300 positions and $19.6 million in related charges offset in part by approximately $2.5 million associated with adjustments to reduce facility consolidation accruals recorded in prior periods.

Valuation and Impairment of Long-lived Assets. In 2001, in light of current and projected market conditions within the communications industry, we performed an analysis as to the recoverability of our long-lived assets. As a result, we recorded a write-down of goodwill totaling $711.5 million associated with our July 2000 acquisition of Algety S.A., a French company that develops and markets high-capacity, high-speed optical networking equipment.

In 2002, we adopted SFAS No. 142 and ceased amortizing goodwill. In the fourth quarter of 2002, under the provisions of SFAS No. 142 and SFAS No. 144, we completed an impairment review of our goodwill. Based on the assessment, we recorded a write-down of goodwill and intangible assets totaling $33.0 million associated with our May 2002 acquisition of Dorsál Networks.

Also in 2002, in light of the outsourcing of our manufacturing operations and the reduction of research and development initiatives, we decommissioned certain fixed assets and reviewed the recoverability of the long- lived assets still in use. As a result, in the fourth quarter of 2002, we recorded impairment charges totaling $74.7 million.

Other Charges—Impairment of Strategic Equity Investment. We have made strategic equity investments in certain startup companies totaling $17.6 million. These investments are initially carried at cost as we own less than 20% of the voting equity and do not have the ability to exercise significant influence over these companies. We recorded charges within other income, net totaling $4.9 million in 2002 and $12.3 million in 2001, associated with the permanent impairment of these investments resulting from the impact of economic conditions on certain of these investees.

Purchased Research & Development. On May 16, 2002, we completed our acquisition of Dorsál Networks, Inc., a privately held provider of next-generation transoceanic and regional undersea optical network solutions, for 41.8 million shares of common stock valued at approximately $91.8 million. The purchase price of Dorsál was allocated to identifiable assets and liabilities acquired and included approximately $34.6 million of purchased in-process research and development that was expensed on the acquisition date.

Interest Income (Expense), Net. Interest income, net of interest expense, decreased to $4.2 million for the year ended December 28, 2002 from $21.2 million of net interest income for the year ended December 29, 2001. The decrease was primarily attributable to lower average invested cash balances from the proceeds of our initial public offering and other private placements, lower average returns on investments net of charges associated with the write-down of certain strategic equity investments.

Liquidity and Capital Resources

Overview

Since inception through December 31, 2003, we have financed our operations, capital expenditures and working capital primarily through public and private sales of our capital stock. At December 31, 2003, our cash and cash equivalents and investments totaled $296.8 million. During 2003 and early in 2004, we have entered into a series of significant transactions, including:

- In June 2003, we invested approximately $81.1 million in cash, net of subsequent purchase adjustments and acquisition costs, to acquire most of the assets and certain of the liabilities of Broadwing Communications Services, Inc.
- In August 28, 2003, we completed a private placement of 67.3 million shares of common stock for net proceeds of $73.8 million.
- In November 2003, we acquired an additional one percent interest in Broadwing and terminated our management services agreement with Cequel for a combination of cash, equity and other consideration. We recorded an $18.5 million restructuring charge associated with this transaction.
- In February 2004, we completed a private placement of senior unsecured convertible notes for proceeds of $225 million.
- Also in March 2004, we agreed to acquire Focal Communications Corporation ("Focal") for total consideration of $210 million.

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Operating Cash Flow

Net cash used in operating activities was $183.4 million, $136.9 million and $255.5 million for the years ended December 31, 2003, December 28, 2002 and December 29, 2001, respectively. Cash used in operating activities for the year ended December 31, 2003 was primarily attributable to a net loss of $260.5 million, and changes in operating assets and liabilities of $56.0 million, offset in part by non-cash charges including depreciation and amortization of $41.4 million, equity-based expense of $20.6 million, and certain non-cash restructuring and other charges of $71.5 million. Cash used in operating activities for the year ended December 28, 2002 was primarily attributable to a net loss of $507.8 million, offset in part by non-cash charges including depreciation and amortization of $70.7 million, equity-based expense of $65.4 million and purchased research and development expense of $34.6 million associated with our acquisition of Dorsal Networks in May 2002 and certain non-cash restructuring charges of $188.5 million. Cash flows from operating activities were further offset by changes in operating assets and liabilities of $11.7 million.

Investing Cash Flow

Net cash used in investing activities for the years ended December 31, 2003, December 28, 2002 and December 29, 2001 was $86.0 million, $36.8 million and $131.5 million, respectively. The increase in net cash used in investing activities for the fiscal year ended December 31, 2003 was primarily attributable to the $81.1 million acquisition, net of purchase adjustments and acquisition costs, of most of the assets and certain liabilities of Broadwing Communications Services, Inc., purchases of property and equipment of $12.2 million and increases in deposits and other long-term investments, offset in part by net sales of short and long-term investments. The decrease in net cash used in investing activities for the year ended December 28, 2002 was primarily attributable to significant reductions in capital expenditures.

On February 23, 2003, we originally agreed to invest approximately $129.0 million, including acquisition costs for most of the assets and certain of the liabilities of Broadwing Communication Services, Inc. This purchase price was subject to a pre-closing reduction of up to $14.3 million if Broadwing Communications Services, Inc. failed to reach certain revenue and EBITDA targets it had established and a post-closing reduction of an additional $10 million if certain EBITDA targets were not reached in a one-year period after the closing. The agreement also committed Broadwing Communications Services, Inc. to make capital expenditures of $3 million each month, consistent with its financial plan. On June 6, 2003, the parties agreed to reduce the purchase price by $7.2 million due to failure to meet the revenue target and by an additional $7.2 million for failure to achieve the targeted reduction in negative cash EBITDA, as defined in the agreement. An additional reduction in the purchase price of approximately $23 million was negotiated to reflect the seller's desire to forego making additional required capital expenditures such as equipment and network upgrades and to accelerate the closing of the transaction. These reduction reduced the purchase price to $92.9 million including acquisition costs. The Broadwing acquisition closed on June 13, 2003. Subsequently in November 2003, the parties agreed on an additional post-closing reduction in the purchase price to $81.1 million, including acquisitions costs as negotiated pursuant to working capital and receivable adjustment obligations set forth in the agreement and our release of any rights to the post-closing adjustment as a result of failure to meet post-closing EBITDA targets.

In February 2004, we signed an agreement to acquire Focal Communications Corporation ("Focal"), a Chicago-based competitive local exchange carrier that provides voice and data solutions to enterprises, carriers and resellers for a total consideration of $210 million, which will be comprised of approximately $101 million in equity to be issued to Focal's equity holders and the assumption or payment of approximately $109 million of Focal's existing debt and other long-term capital lease obligations. Focal operated in 23 Tier 1 markets from Boston to Miami and New York to Los Angeles and owns metro fiber footprint in nine Tier 1 national markets and maintains a 4,000 enterprise and wholesale/carrier customer base.

As part of our efforts to lower overall cost of service associated with Broadwing, we have implemented a series of capital projects associated with the Broadwing network infrastructure. These capital programs will continue in 2004 with projected spending of $3.0 to $6.0 million per quarter. During 2003, capital projects included $13.7 million of equipment division inventory that was transferred to the Broadwing network at its net carrying value. As part of our efforts to improve and expand the Broadwing network, we will likely install Corvis inventory that has previously been written-down to zero value as well as network elements previously capitalized as research and development fixed assets within our equipment division. The decision to use this equipment is dependent on further cost-benefit analysis, expansion requirements and interoperability.

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Financing Cash Flow

Net cash provided by financing activities for the year ended December 31, 2003 was $67.6 million, primarily attributable to the August 28, 2003 private placement of approximately 67.3 million shares of common stock for proceeds of $73.8 million, net of offering costs and proceeds from stock and warrant exercises offset in part by treasury stock purchases and capital lease payments. We have granted the private placement investors additional investment rights to purchase up to an additional 13.5 million shares of our common stock at $1.30 per share. Net cash used in financing activities for the year ended December 28, 2002 was $10.0 million, primarily attributable to the repayment of principal on notes and capital leases as well as the purchase of treasury stock. Net cash provided by financing activities for the year ended December 29, 2001 was $1.5 million, primarily attributable to the sale of investments associated with restricted cash and proceeds from stock options and warrants exercised, offset in part by the repayment of principal on notes and capital leases.

In February 2004, Corvis completed a private placement of $225 million of senior unsecured convertible notes with several institutional investors. The rates have a final maturity date of two years from issuance and bear interest at a rate of five percent per annum. Interest is payable quarterly at Corvis' option in cash or, subject to certain conditions, in registered shares of Corvis common stock at a five percent discount to the Company's common stock trading price at the time of payment. The notes are convertible at the investors' option at any time into Corvis common stock at a fixed conversion price of $5.75 per share, subject to anti-dilution adjustments. Principal is payable in quarterly installments beginning August 19, 2004. We intend to use the net proceeds to support the general operations of our Broadwing subsidiary and to support new market initiatives within Broadwing, as for well as working capital requirements for strategic acquisitions.

Corvis has the option, beginning six months after closing (August 19, 2004), to cause the investors to subscribe to the placement of up to an additional $75 million in senior unsecured convertible notes having a final maturity date of two years after that issuance and otherwise having similar terms as the initial senior unsecured convertible notes.

We are contractually committed to register shares that investors bought in connection with our August 28, 2003 private placement. However, we have been unable to do so due to Broadwing's predecessor auditors' inability to consent to our referencing certain financial statements they audited relating to the Broadwing business while it was owned by Cincinnati Bell. Allegations have been made that such financial statements contained inaccuracies and Cincinnati Bell's Audit Committee has launched an internal investigation. Until we, and the predecessor auditors, are satisfied that such allegations have been appropriately addressed or until we no longer are required to reference such financials, expected in mid-2005, we will be unable to register the private placement or any other securities.

Our inability to register our shares due to the Cincinnati Bell issue could have a material adverse effect on our cash position. Under our agreement with the August 28, 2003 private placement purchasers, we are obligated to pay them $0.8 million per month for each additional month of delay after December 26, 2003 in registering the resale of their securities. In addition, if we are not able to have a registration statement effective for the purchasers of $225 million our Senior Unsecured Convertible Notes by August 17, 2004, we will owe them a penalty equal to two percent of $225 million for the first month of delay and one percent for each additional month of delay up to a maximum of five percent. If we still do not have a registration statement effective for the noteholders by October 16, 2004, the noteholders could declare an event of default and we would be obligated to pay them 111% (less any previously paid penalties) of the $225 million, as well as accrued interest.

Also, in connection with our agreement to purchase Focal, if we do not have a registration statement filed by July 1, 2004, which we could only do if the registration statement for our August 28, 2003 private placement has already become effective, then we are obligated, at the investor's election, to close with cash instead of shares of our common stock, an amount we estimate at $101 million.

In addition, absent an amendment to the agreement under which we issued the Senior Unsecured Convertible Notes, if we have not been able to register the shares issued under the notes, we will not be permitted to assume debt and, absent other arrangements, we may be obligated to repay indebtedness of Focal in an aggregate amount of up to $109 million.

Finally, in connection with our agreements with Cequel III, if at the time we fulfill our obligation of registering the 2.8 million shares we have previously issued to them, such shares do not have a market value of at least $3.4 million, we are obligated to issue them additional shares (up to 2.8 million additional shares) necessary to bring the total market value of such shares up to such market value.

Based on discussions with Cincinnati Bell and the associated external auditors, we believe that this issue will be resolved during the early portion of 2004. There can be no assurances, however, as to if and when this issue will be resolved. We plan to undertake action to reduce the risks outlined above by commencing to arrange for alternative financing should we be obligated to make one or more of the identified cash payments. In addition, we are in discussions with the holders of our Senior Unsecured Convertible Notes to amend the terms of such notes to permit our incurrence of indebtedness in connection with acquisitions below the threshold of $100 million aggregate indebtedness prior to effectiveness of a registration statement relating to such notes and the related warrants and to provide for greater flexibility in raising additional funds if necessary if they declare an event of default, and accelerate payment of the notes, for failure to timely register the sale of their shares.

As of December 31, 2003, long-term restricted cash totaled $7.0 million associated with outstanding irrevocable letters of credit relating to lease obligations for various manufacturing and office facilities and other business arrangements. These letters of credit are collateralized by funds in our operating account. Various portions of the letters of credit expire at the end of each respective lease term or agreement term.

On October 24, 2002, we announced that our Board of Directors had had authorized a share repurchase program under which we can acquire up to $25 million of our common stock in the open market. Cumulative at December 31, 2003, 12,281,800 shares had been purchase under the plan for a total of $9.5 million. The purchases will be executed at times and prices considered appropriate by us through October 2004. The share repurchase program may be suspended at any time and from time-to-time without prior notice. The repurchase program will be funded using our existing cash balances and the repurchased shares may be use for corporate purposes in compliance with applicable law.

We believe that our current cash and investments and cash generated from operations will satisfy our expected working capital, capital expenditure and investment requirements beyond the next twelve months.